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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2016/2017

PPE0054 – BASIC MACROECONOMICS
(Foundation in Business)

6 MARCH 2017
2.30 p.m. – 4.30 p.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This question paper consists of **TEN** pages.
2. Answer **ALL** questions in **Section A** and **B**.
3. The answers for **Section A** should be shaded on the OMR sheet. The answers for **Section B** should be written in the Answer Booklet.

SECTION A: MULTIPLE CHOICE QUESTIONS [30 MARKS]

Instructions: Answer **ALL** questions in this section. Shade the answers on the OMR sheet.

1. In December 2009, currency was \$400 billion, traveller's cheques were \$5 billion; checkable deposits owned by individuals and businesses were \$600 billion, saving deposits were \$200 billion, time deposits were \$1,500 billion; and money market funds were \$1,200 billion. What was the M1 in December 2009?
 - A. M1 = \$405 billion
 - B. M1 = \$3500 billion
 - C. M1 = \$1,005 billion
 - D. M1 = \$3,005 billion
2. To function as money, something must hold its purchasing power over time. That is, it must be a _____.
 - A. store of value
 - B. unit of accounting
 - C. medium of exchange
 - D. standard of deferred payment
3. When the bank makes a loan, it _____.
 - A. increases its reserves
 - B. creates a checkable deposit
 - C. decreases the quantity of money
 - D. borrows the money from the central bank
4. Assume Riley deposits \$4,000 cash in her checkable deposit at Fershur Bank. If the required reserve ratio is 5 percent, Fershur Bank's _____.
 - A. excess reserves increase by \$4,000
 - B. liabilities do not change but its assets increase
 - C. assets and its liabilities change in opposite directions
 - D. required reserves increase by \$200 and its excess reserves increase by \$3,800
5. When the central bank buys government securities, _____.
 - A. reserves increase, leading to a decrease in the money supply by an amount more than the purchase of the government securities.
 - B. reserves decrease, leading to an increase in the money supply by an amount more than the purchase of the government securities.
 - C. reserves increase, leading to an increase in the money supply by an amount more than the purchase of the government securities.
 - D. reserves decrease, leading to a decrease in the money supply by an amount more than the purchase of the government securities.

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6. John gets paid monthly and pays for everything with cash. When he cashes his cheque, he keeps RM200 for food, RM100 for utilities, RM900 for rent, RM50 for transportation, RM100 for entertainment and RM300 for unexpected expenditures. Which of the following statements is **TRUE**?

- The transactions demand for money is RM1,350, the precautionary demand is RM300 and the asset demand is RM0.
- The transactions demand for money is RM450, the precautionary demand is RM300 and the asset demand is RM900.
- The transactions demand for money is RM350, the precautionary demand is RM1,150 and the asset demand is RM150.
- The transactions demand for money is RM350, the precautionary demand is RM950 and the asset demand is RM0.

7. An excess quantity of money supplied will _____.
A. decrease income
B. raise bond prices
C. raise interest rates
D. decrease investment

8. If the central bank increases the reserve requirement ratio, the _____.
A. money supply increases, and the money supply curve shifts to the left
B. money supply decreases, and the money supply curve shifts to the left
C. money supply increases, and the money supply curve shifts to the right
D. money supply decreases, and the money supply curve shifts to the right

9. If the CPI decreases from one year to the next, then the inflation rate is _____.
A. positive
B. negative
C. above 100
D. below 100

10. Because the inflation rate is so high, Wanda refuses to carry cash. Even though it is a bother, she now goes to the ATM twice as often to get the cash she needs. Wanda's actions are an example of the _____.
A. menu costs of inflation
B. confusion costs of inflation
C. uncertainty costs of inflation
D. shoe-leather costs of inflation

11. You lend RM5,000 to a friend for one year at a nominal interest rate of 10%. The CPI over that year rises from 180 to 190. What is the real rate of interest you will earn?
A. 0%
B. 4.4%
C. 5.5%
D. 5.8%

Continued...

12. You agree to lend \$1,000 for one year at a nominal interest rate of 10%. You anticipate that inflation will be 4% over that year. If inflation is instead 3% over that year, which of the following is TRUE?

- A. The real interest rate you earn on your money will be negative.
- B. The real interest rate you earn on your money is lower than you expected.
- C. The purchasing power of the money that will be repaid to you will be lower than you expected.
- D. The person who borrowed the \$1,000 will be worse off as a result of the unanticipated decrease in inflation.

13. Which of the following is an example of a worker experiencing frictional unemployment?

- A. A Firefly pilot loses his job because of lack of demand for air travel.
- B. An employee is laid off because the economy is suffering a recession.
- C. A worker quits his job at the Post Office to find more interesting work.
- D. A computer programmer loses her job because it is outsourced to India.

14. An increase in cyclical unemployment will result in _____.

- A. a decrease in frictional unemployment
- B. an increase in the unemployment rate
- C. an increase in structural unemployment
- D. an increase in the natural rate of unemployment

15. If the working age population _____ and the labour force does not change, the _____.

- A. increases; unemployment rate will increase
- B. decreases; unemployment rate will increase
- C. increases; labour force participation rate will increase
- D. increases; labour force participation rate will decrease

16. If aggregate demand decreases, the _____.

- A. short-run Phillips curve shifts leftward
- B. short-run Phillips curve shifts rightward
- C. economy moves to a lower inflation rate along its short-run Phillips curve
- D. economy moves to a higher inflation rate along its short-run Phillips curve

17. Which of the following would decrease the current account balance of the United States?

- A. A decrease in imports
- B. A decrease in the amount of money the U.S. government sends in foreign aid to other countries
- C. A decrease in the balance of trade
- D. A decrease in the amount of income U.S. companies pay out to foreigners who own investments in the U.S

Continued...

18. If the current account balance is negative, net interest is RM100 billion and net transfer is -RM100 billion, then _____.
A. exports exceed imports
B. imports exceed exports
C. the official settlements account must be positive
D. the official settlements account must be negative

19. The U.S. capital account balance is equal to _____.
A. foreign investment in the United States minus U.S. investment abroad
B. U.S. investment abroad minus foreign investment in the United States
C. foreign assets owned by the United States minus U.S. assets owned by foreigners
D. the value of exports of U.S. capital goods minus the value of imports of capital goods into the United States

20. When the U.S. official reserves _____, the official settlements account balance becomes negative and when the U.S. official reserves _____, the official settlements account balance becomes positive.
A. increase; increase
B. decrease; increase
C. increase; decrease
D. decrease; decrease

21. A persistent shortage of yen at a given fixed exchange rate (in dollars per yen) is evidence that the yen is _____ versus the dollar. This shortage can be reduced or eliminated through a _____ of the yen.
A. undervalued; devaluation
B. undervalued; revaluation
C. overvalued; revaluation
D. overvalued; devaluation

22. If the exchange rate changes from 1.00 euro per dollar to 1.10 euros per dollar, the euro has _____.
A. depreciated against the euro
B. appreciated against the euro
C. appreciated against the dollar
D. depreciated against the dollar

23. On the foreign exchange market, an increase in a country's exchange rate _____.
A. decreases the demand for its currency and shifts the demand curve leftward
B. decreases the demand for its currency and shifts the demand curve rightward
C. decreases the quantity demanded for its currency and leads to an upward movement along the demand curve
D. increases the quantity demanded for its currency and leads to a downward movement along the demand curve

Continued...

24. When the U.S. interest rate _____ relative to foreign interest rates, the supply of dollars _____ and the supply curve of dollars shifts rightward.

- A. falls; increases
- B. rises; increases
- C. falls; decreases
- D. rises; decreases

25. When a country imports a good, the _____ to consumers is _____ the _____ to producers.

- A. gain; larger than; loss
- B. loss; larger than; gain
- C. loss; smaller than; gain
- D. gain; smaller than; loss

26. Which of the following group is hurt by a tariff?

- A. foreign government
- B. domestic government
- C. domestic producers of the good
- D. domestic consumers of the good

27. Assume that China has a comparative advantage in producing corn and exports corn to Japan. We can conclude that _____.

- A. labour costs are higher for corn producers in Japan than in China
- B. China has a lower opportunity cost of producing corn relative to Japan
- C. Japan has an absolute disadvantage in producing corn relative to China
- D. China also has an absolute advantage in producing corn relative to Japan

28. With no international trade, the Canada price of wheat is lower than the world price of wheat. This indicates that Canada _____ a comparative advantage in the production of wheat and with international trade, Canada will _____ wheat.

- A. has; export
- B. has; import
- C. might have; export
- D. does not have; export

29. If the world price of a good is below the no-trade domestic price, a country _____.

- A. will benefit from exporting the good
- B. will benefit from importing the good
- C. will not engage in trade for that good
- D. has a comparative advantage in the production of that good

30. Based on the following option, who gains from international trade?

- A. Only the exporting nation
- B. Only the importing nation
- C. Both the importing and the exporting nations
- D. The gains depends on which nation gets to keep the total revenue from the sale

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SECTION B: STRUCTURED QUESTIONS [70 MARKS]

Instructions: Answer **ALL** questions in this section. Write your answers in the Answer Booklet.

Question 1

Part A

Suppose Bank of Commerce has assets that composed of required reserves equals RM2 million and loans amounting to RM8 million. The bank exactly satisfies its reserves requirement, and it holds no excess reserves. Assume that, Bank of Commerce's only liabilities are checkable deposits.

- a) Prepare a balance sheet for the Bank of Commerce based on the above information. (2 marks)
- b) Calculate the reserve requirement ratio. (2 marks)
- c) Suppose a bond dealer comes to the Bank of Commerce and deposits RM2 million. Assuming that no currency leakages occur, calculate the maximum amount of new loan that Bank of Commerce can make. (4 marks)
- d) If the bank can loan out as much as it can, show the new balance sheet for the Bank of Commerce. (2 marks)
- e) What is the value of the money multiplier? (2 marks)
- f) After infinite rounds of depositing and lending, how much would be the total increase in deposits in the entire banking system? (2 marks)

Part B

Exhibit 1 shows money demand schedule in trillions of dollars.

Nominal interest rate (percent per year)	Quantity of money demanded (trillions of dollars)
5	2.9
6	2.8
7	2.7
8	2.6
9	2.5
10	2.4

Exhibit 1

Based on ***Exhibit 1***, answer the following questions.

- a) If the central bank supplies \$2.7 trillion, what is the equilibrium nominal interest rate?

(1 mark)

Continued...

b) Discuss how equilibrium is restored if the interest rate is greater than the equilibrium rate found in (a). (2 marks)

c) If the central bank decreases quantity of money by \$0.1 trillion, explain what would happen to the equilibrium nominal interest rate. (3 marks)

[TOTAL 20 MARKS]

Question 2

Part A

Exhibit 2 describes the economy of U.S. in year 2010.

Item	Dollar amount (billion)
Merchandise exports	400
Services (exports)	80
U.S. investment abroad	33
Statistical discrepancy	- 29
Income from U.S assets abroad	15
Foreign investment in the U.S	50
Increase in U.S. official reserve assets	5
Income from foreign assets in U.S	20
Decrease in foreign official reserve assets in the U.S.	4
Merchandise imports	410
Services (imports)	34
Net unilateral transfers	-18

Exhibit 2

Based on ***Exhibit 2***, calculate

a) merchandise trade balance. (1.5 marks)

b) current account balance. (4 marks)

c) capital account balance. (1.5 marks)

d) the official reserve balance. (1.5 marks)

e) balance of payments. (2.5 marks)

Continued...

Part B

Suppose the total number of workers in Country A is 16,800. Also assume that the number of workers who are frictionally, structurally and cyclically unemployed is as given in *Exhibit 3*, and the number of discouraged workers is 800.

Category	Number of workers
Frictional unemployment	500
Structural unemployment	700
Cyclical unemployment	1,200

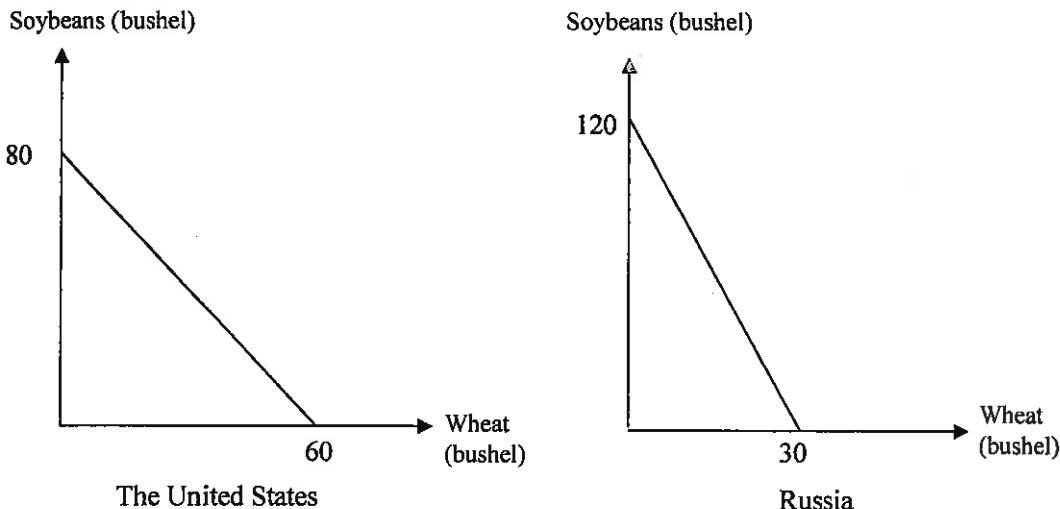
Exhibit 3

- Calculate the size of labour force. (2 marks)
- Calculate the unemployment rate. (2 marks)
- Calculate the natural rate of unemployment. (2 marks)
- What is meant by discouraged workers? (1 mark)
- Briefly explain the difference between frictional unemployment and cyclical unemployment. (2 marks)

[TOTAL 20 MARKS]

Question 3**Part A**

Consider two countries, Russia and the United States, each capable of producing soybeans and wheat. Assume that for a given amount of inputs, the production possibilities for these two countries are as shown in *Exhibit 4*.

*Exhibit 4*

Continued...

a) How many bushels of wheat does each country give up for an additional bushel of soybeans produced? (3 marks)

b) How many bushels of soybeans does each country give up for an additional bushel of wheat produced? (3 marks)

c) Which country has a comparative advantage in producing soybeans? Briefly explain. (1 mark)

d) Which country has a comparative advantage in producing wheat? Briefly explain. (1 mark)

e) If these two countries split the difference between the buyer's willingness to pay and the seller's willingness to accept, what are the terms of trade for each bushel of soybeans? (1 mark)

f) Suppose each country specialises in the good for which it has comparative advantage, and they exchange 40 bushels of soybeans for some bushels of wheat. Compute the consumption bundles of wheat and soybeans for each country. (2 marks)

Part B

Exhibit 5 shows the U.S. demand and supply schedules of canned grapes.

Price (\$)	Quantity demanded	Quantity supplied
8	1100	0
10	900	100
12	700	300
14	500	500
16	300	700
18	100	900
20	0	1100

Exhibit 5

a) In the absence of trade, what would be the price of canned grapes and the level of production in the United States? (2 marks)

b) If the world price of canned grapes is RM12 per can and the United States engages in trade, does the United States import or export canned grapes? What is the quantity imported or exported? (2 marks)

c) Calculate the value of consumer surplus before and after trade. (2 marks)

d) Calculate the value of producer surplus received by grape producers before and after trade. (2 marks)

e) If trade is allowed, who gains and who losses, the consumers or the producers? (2 marks)

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Part C

a) Graph the supply and demand for the foreign exchange market, expressed in terms of Malaysian ringgit per U.S dollar. Show the equilibrium exchange rate at RM4 per dollar. (3 marks)

b) Suppose that now the exchange rate between ringgit and dollar is fixed at RM3.80 per dollar. Show this fixed exchange rate in the diagram drawn in part (a). (2 marks)

c) Based on (b),

- i) has ringgit overvalued or undervalued? (1 mark)
- ii) what would happen to balance of payments of Malaysia? (1 mark)
- iii) if Malaysia wish to maintain the fixed exchange rate, will the central bank of Malaysia need to buy dollar in exchange of ringgit or sell dollar in exchange for ringgit? (1 mark)
- iv) what would happen to Malaysia's international reserves if the fixed exchange rate is maintained at RM3.80 per dollar? (1 mark)

[TOTAL 30 MARKS]**End of Paper**